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STATEMENT OF
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BEFORE THE
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
HOUSE COMMITTEE ON VETERANS AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES
ON
PROCURING PHARMACEUTICALS FOR
THE DEPARTMENT OF DEFENSE

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Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to be here this morning to discuss the views of the Office of the Inspector General, Department of Defense, regarding the procurement of pharmaceutical products by the Departments of Defense and Veterans Affairs.

The Defense Logistics Agency supports the Military Departments with medical items through its subordinate agency, the Defense Supply Center Philadelphia. The Supply Center purchases items for either direct delivery to the customer or delivery to a Defense depot for storage until they are needed. The Defense Logistics Agency recovers administrative and overhead costs by charging customers a surcharge on each item. Although military treatment facilities also purchase some items on local contracts or by using credit cards for small purchases, the bulk of the Defense procurement activity for pharmaceuticals is by the Defense Supply Center Philadelphia.

Review of Medical Items

In June 1998, we issued an audit report 1/ that addressed purchases of medical items by the Defense Logistics Agency and Department of Veterans Affairs. The intent of our review was to look at the extent of medical items available through the Department of Veterans Affairs that were also managed and purchased by the Defense Logistics Agency. For this hearing, I will focus on the audit results related to pharmaceuticals. The following Table shows the scope and complexity of Defense Logistics Agency and Department of Veterans Affairs pharmaceutical procurement activity in FY 1997, when the audit was performed.

	<u>Defense Logistics Agency</u>	<u>Department of Veterans Affairs</u>
Expenditures	\$751 M	\$1,696 M
Line Items Acquired	25,102	21,666

1/ 98-154, Acquisition of Medical Items, June 15, 1998. The report is available at www.dodig.osd.mil.

During that timeframe, the Defense Logistics Agency had 106 personnel slots dedicated to pharmaceuticals acquisition and 65 to medical readiness item management, including both pharmaceuticals and other medical items.

We found extensive overlap between the Defense and Veterans Affairs purchasing programs. By matching National Drug Codes, we identified 15,727 pharmaceutical products being purchased by both organizations. There were thousands of other items, such as cremes, without a National Drug Code, so the duplication was likely much greater. Let me emphasize that I am referring to duplication in the sense of buying the same types of products, not making multiple procurements of the same items to fill the same customer orders.

We performed a price comparison for 200 pharmaceuticals purchased by both Departments. Our comparison showed that the Department of Veterans Affairs price was lower for 165 of 200 items (83 percent). For 123 of the 165 items, however, the price differences were less than 1 percent.

We also determined that the Defense Logistics Agency and Department of Veterans Affairs used very similar acquisition strategies. They both contracted with prime vendors for direct

delivery to users, who placed their own orders and usually received next day delivery. The use of prime vendors and direct vendor delivery are considered best commercial practices and the Defense Logistics Agency pharmaceutical program was one of the first and most successful DoD applications of those practices. The use of prime vendors and direct vendor delivery means that the traditional logistics functions of centrally processing requisitions and maintaining stock on-hand in depots are usually no longer performed. The Defense Logistics Agency and the Department of Veterans Affairs essentially provided only a contracting role. In this role, we could discern no major difference between services provided to medical treatment facility customers by the Defense Logistics Agency and the Department of Veterans Affairs.

Industry Perspective

Most manufacturers and prime vendors viewed dual acquisition of medical items by the two Departments as inefficient. In response to our questionnaires, 11 of 15 manufacturers stated they incurred additional administrative expenses dealing with multiple Government agencies. We also discussed the issue of dual procurements by the two Departments with the Health Industry Distributors Association and six prime vendor

representatives. All were consistent in their criticism of dual acquisition of medical items, which also caused the distributors to incur additional administrative expense from bidding multiple contracts and maintaining separate records for both Departments.

Customer Perspective

We discussed the issue of purchasing pharmaceuticals with nine military treatment facilities. To obtain pharmaceuticals, six facilities used Defense Logistics Agency prime vendor contracts and three facilities used Department of Veterans Affairs prime vendor contracts. The prime vendors supplied 81 to 92 percent of the facilities' pharmaceuticals. The facilities expressed preferences for certain aspects of both Defense Logistics Agency and Department of Veterans Affairs contracting services. Their decisions to choose either a Defense Logistics Agency or Department of Veterans Affairs prime vendor contract were based more on precedent than on the result of in-depth evaluation.

Benefits of Separate Planning and Purchasing

Defense Logistics Agency officials asserted the need to retain their medical item acquisition capability by pointing to the

requirements for performing a readiness function, providing better customer support, and using improved business practices.

The Military Departments have estimated that about 4 percent of medical items are critical and require special planning for military contingencies. A Defense Logistics Agency readiness group identifies special provisions needed for those critical items and the contracting group negotiates surge options with prime vendors or, in some instances, buys items for storage. This same group that identifies readiness provisions for operationally critical items could also furnish them to the Department of Veterans Affairs for negotiating surge requirements in contracts and purchasing items for storage.

We see no reason why Defense should not be able to rely on Veterans Affairs to provide responsive contract management support for contingency situations. The Army stated that Veterans Affairs successfully supported the deployment of Fort Hood units to Kuwait in 1996 by exercising surge options in a prime vendor contract for pharmaceuticals.

We also concluded that the Department of Veterans Affairs and Defense Logistics Agency provided essentially the same level of

customer support and used the same commercial-type business practices.

Benefits of Combined Purchasing

Although we agree that the Defense Logistics Agency should retain responsibility for determining military readiness provisions for critical pharmaceuticals, a strong case can be made for merging the Defense and Veterans Affairs purchasing activities. Benefits would include the following:

First, the Government would present one face to suppliers and cut the suppliers' administrative costs, enabling those savings to be reflected in prices.

Second, the Government would be able to cut its own administrative costs.

Third, the Government's negotiating leverage in the marketplace could be improved.

Fourth, Defense customers might get additional price breaks because of a lower Veterans Affairs surcharge.

Fifth, the Defense Logistics Agency could realign its resources to help compensate for major staffing reductions in other areas.

Response to Report

Our June 1998 report recommended that the Department of Defense transfer acquisition responsibility for medical items to the Department of Veterans Affairs except for militarily unique medical items. The Department of Defense responded that it partially agreed and would form a team to work with the Department of Veterans Affairs to expand cooperation, especially in terms of achieving one face to industry on pricing issues. Subsequently, a June 29, 1999, Memorandum of Agreement was signed between the Departments and we accepted its terms as being generally responsive to the audit finding.

The agreement allows each Department to continue contracting for pharmaceuticals, but requires a sharing of pricing information on contracts, migrates Defense medical facilities using Department of Veterans Affairs prime vendor contracts to Defense prime vendor contracts and prohibits each agency from marketing their prime vendor contracts to the other Department's medical facilities. Defense agreed to incorporate Department of Veterans Affairs pharmaceutical contract prices into its Defense

Electronic Catalogs. Further, the Joint Federal Pharmacy Executive Steering Committee will identify requirements and negotiate committed use contracts for the use of both Departments. The intent is to establish one face to industry on pricing issues and expand joint contracting. We were informed on March 3, 2000, that the Defense Logistics Agency expects annual savings of \$50 million from the initiatives, with additional savings for the Department of Veterans Affairs. We have not reviewed the implementation of the Memorandum of Agreement and the joint initiatives or the savings estimate.

Conclusion

The overall DoD acquisition workforce has been cut in half over the past several years, with no proportionate decrease in workload. The Defense Logistics Agency should not retain any more pharmaceutical procurement workload than absolutely necessary to handle unique DoD management problems that the Department of Veterans Affairs lacks the resources and expertise to handle. In our view, such unique requirements are minimal and we remain hopeful that Defense will gradually shift routine procurement workload to Veterans Affairs. The main opportunity for cost reduction, however, lies in achieving the best possible prices. We are encouraged by reports of progress in that

regard. The ongoing effort to implement the 1999 Memorandum of Agreement should be monitored to ensure that both sides are genuinely committed to minimizing duplication, enhancing the Government's best interest, and reducing customer costs. Thank you for your interest in my office's views on this matter.